

## **The Fundamentals of Debt Financing: Role of the Underwriter**

May 6, 2004

**By Dawn Vincent**  
**Stone & Youngberg LLC**

# Introduction

- ◆ **The primary role of the underwriter is to purchase securities from the issuer and resell them to investors**
- ◆ **Underwriters act as intermediaries between issuers and investors, providing for an efficient flow of capital**
- ◆ **The underwriter takes the risk that it will be able to resell the securities at a profit**

# Competitive vs. Negotiated

## ◆ Two types of municipal bond sales

### ☐ Competitive

- Underwriters bid against one another to buy the issuer's securities
- Generally, all-in interest cost is the only determinant
- Minimal issuer interaction with underwriter prior to sale

### ☐ Negotiated

- Underwriter selected by issuer prior to sale
- Underwriter provides scope of services prior to and after sale
- Negotiation - Interest rates and underwriter's compensation

# Underwriter's Scope of Services in Negotiated Sale Prior to Bond Sale

- ◆ **Develop a financing plan with the issuer, including analysis of alternatives**
- ◆ **Develop time & responsibility schedule, provide task-related quarterbacking of the financing team**
- ◆ **Assist bond counsel, disclosure counsel and/or underwriter's counsel in preparation of legal and disclosure documents**

# Underwriter's Scope of Services in Negotiated Sale Prior to Bond Sale

- ◆ **Develop rating agency presentations and assist issuer with communications with rating analysts**
- ◆ **Solicits select municipal bond insurance companies to obtain insurance bids on behalf of issuer**

# Sample Bond Sale Schedule

| DAY | TASK   |
|-----|--|
| 1   | Issuer decides to finance a project  |
| 10  | Finance team is selected and assembled   |
| 15  | Revenue stream securing the debt is identified and analyzed                                  |
| 21  | Issuer and finance team determine the debt structure   |
| 28  | Legal and disclosure documents are crafted   |
| 38  | Credit ratings/bond insurance secured  |
| 45  | Council / Board approves the legal and disclosure documents and authorizes the debt issuance |
| 52  | Underwriter markets the debt to investors  |
| 59  | Underwriter commits to buy the debt from issuer  |
| 75  | Transaction is closed and the project is funded  |

# Underwriter's Scope of Services in Negotiated Sale Prior to Bond Sale

## ◆Market the issuer's securities in advance of sale date

 Investor relation calls / site tours

 Research reports

 In-house sales calls

 Advertising

# Underwriter's Scope of Services in Negotiated Sale Prior to Bond Sale

## ◆ Provide recommendations to issuer with respect to structuring of securities

- Serial vs. term bonds


- Interest rates

- Call features

- Use of bond insurance



# Recent Marketing Sales Sheet

|   |                      |
|---|----------------------|
|  |                      |
| <b>Final</b>  |                      |
| <b>\$6,465,000</b>  |                      |
| <b>San Marcos Schools Financing Authority</b>                                     |                      |
| <b>2004 Lease Revenue Bonds</b>   |                      |
| <b>(North County Regional Education Center)</b>                                   |                      |
| <hr/>   |                      |
| <b>Dated:</b>   | April 8, 2004        |
| <b>Delivery:</b>  | April 8, 2004        |
| <b>First Coupon:</b>  | November 1, 2004     |
| <b>Optional Call:</b>   | 11/1/12 @ par        |
| <b>S &amp; P:</b>   | AAA                  |
| <b>Moody's:</b>   | N/A                  |
| <b>Insurer:</b>   | XL Capital Assurance |
| <b>Registration:</b>  | DTC Book-Entry Only  |
| <hr/>   |                      |
| <b>Serial</b>   | <b>Date</b>          |
| <b>Bonds</b>  | <b>Principal</b>     |
|   | <b>Coupon</b>        |
|   | <b>Yield</b>         |
|   | <b>Price</b>         |
|   | 11/1/2004            |
|   | 11/1/2005            |
|   | 11/1/2006            |
|   | 11/1/2007            |
|   | 11/1/2008            |
|   | 11/1/2009            |
|   | 11/1/2010            |
|   | 11/1/2011            |
|   | 11/1/2012            |
|   | 11/1/2013            |
|   | 11/1/2014            |
|   | 11/1/2015            |
|   | 11/1/2016            |
|   | 11/1/2017            |
|   | 11/1/2018            |
|   | 11/1/2019            |
|   | 11/1/2020            |
|   | 11/1/2021            |
| <b>Term</b>   |                      |
| <b>Bond</b>   | 11/1/2024            |
|   | <b>Total Issue</b>   |
|   | <b>\$6,465,000</b>   |
| <hr/>   |                      |
| <b>2024 Term Bond</b>   |                      |
|   | 11/1/2022            |
|   | 11/1/2023            |
|   | 11/1/2024            |
|   | 1,230,000            |

|   |                      |
|---|----------------------|
| <b>Final</b>                                    |                      |
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| <b>Moody's:</b>                                 | N/A                  |
| <b>Insurer:</b>                                 | XL Capital Assurance |
| <b>Registration:</b>                            | DTC Book-Entry Only  |
| <hr/>   |                      |
| <b>Date</b>                                     | <b>Principal</b>     |
| <b>Coupon</b>                                   | <b>Yield</b>         |
| <b>Price</b>                                    |                      |
| 11/1/2004                                       | \$325,000            |
| 11/1/2005                                       | 230,000              |
| 11/1/2006                                       | 235,000              |
| 11/1/2007                                       | 240,000              |
| 11/1/2008                                       | 245,000              |
| 11/1/2009                                       | 250,000              |
| 11/1/2010                                       | 260,000              |
| 11/1/2011                                       | 265,000              |
| 11/1/2012                                       | 270,000              |
| 11/1/2013                                       | 280,000              |
| 11/1/2014                                       | 290,000              |

# Underwriter's Scope of Services in Negotiated Sale At Time of Bond Sale

## ◆ Price the issuer's securities based on

- ☞ Comparable securities in the marketplace

- ☞ Current market conditions

- ☞ Success of marketing efforts

# Comparable Financings

## Recent Insured (Aaa) Transactions

|                        | San Marcos SFA    |   |       | Stanislaus County Series A |   |       | Stanislaus County Series B |   |       | Manhattan Beach USD |   |       | Santa Rosa         |   |       |
|------------------------|-------------------|---|-------|----------------------------|---|-------|----------------------------|---|-------|---------------------|---|-------|--------------------|---|-------|
| <b>Pricing:</b>        | 3/25/2004         |   |       | 3/25/2004                  |   |       | 3/25/2004                  |   |       | 3/24/2004           |   |       | 3/24/2004          |   |       |
| <b>Par Amount:</b>     | \$6,465,000       |   |       | \$15,375,000               |   |       | \$27,515,000               |   |       | \$18,400,000        |   |       | \$22,525,000       |   |       |
| <b>Financing Type:</b> | Lease Revenue     |   |       | COP                        |   |       | COP                        |   |       | GO                  |   |       | Wastewater Revenue |   |       |
| <b>Sale Type:</b>      | Negotiated        |   |       | Competitive                |   |       | Competitive                |   |       | Negotiated          |   |       | Negotiated         |   |       |
| <b>Underlying:</b>     | None              |   |       | None                       |   |       | None                       |   |       | --/AA/--            |   |       | A2/A/--            |   |       |
| <b>Insurance:</b>      | XL Capital        |   |       | Ambac                      |   |       | Ambac                      |   |       | MBIA                |   |       | FGIC               |   |       |
| <b>Underwriter:</b>    | Stone & Youngberg |   |       | UBS                        |   |       | UBS                        |   |       | Piper Jaffray       |   |       | Stone & Youngberg  |   |       |
|                        | <i>Final</i>      |   |       |                            |   |       |                            |   |       |                     |   |       |                    |   |       |
| 2004                   | 2.000             | @ | 1.000 |                            |   |       |                            |   |       | 2.000               | @ | 0.950 | 2.000              | @ | 0.950 |
| 2005                   | 2.000             | @ | 1.150 |                            |   |       |                            |   |       | 2.000               | @ | 1.000 | 2.000              | @ | 1.050 |
| 2006                   | 2.000             | @ | 1.300 | 1.625                      | @ | 1.270 | 1.625                      | @ | 1.270 | 2.000               | @ | 1.150 | 2.000              | @ | 1.250 |
| 2007                   | 2.000             | @ | 1.650 | 2.125                      | @ | 1.550 | 2.125                      | @ | 1.550 | 2.000               | @ | 1.400 | 2.000              | @ | 1.450 |
| 2008                   | 2.500             | @ | 2.050 | 2.125                      | @ | 1.950 | 2.125                      | @ | 1.950 | 2.000               | @ | 1.750 | 2.000              | @ | 1.830 |
| 2009                   | 2.500             | @ | 2.300 | 2.250                      |   |       | 2.250                      |   |       | 2.500               | @ | 2.050 | 4.000              | @ | 2.090 |
| 2010                   | 2.500             | @ | 2.600 | 2.625                      | @ | 2.530 | 2.625                      | @ | 2.530 | 2.500               | @ | 2.400 | 4.000              | @ | 2.400 |
| 2011                   | 3.000             | @ | 2.880 | 3.000                      | @ | 2.730 | 3.000                      | @ | 2.730 | 3.000               | @ | 2.700 | 4.000              | @ | 2.750 |
| 2012                   | 3.000             | @ | 3.200 | 3.000                      |   |       | 3.000                      |   |       | 3.250               | @ | 2.900 | 4.000              | @ | 3.000 |
| 2013                   | 3.250             | @ | 3.400 | 3.250                      | @ | 3.150 | 3.250                      | @ | 3.150 | 5.000               | @ | 3.100 | 3.125              | @ | 3.150 |
| 2014                   | 3.250             | @ | 3.530 | 3.500                      | @ | 3.400 | 3.500                      | @ | 3.400 | 5.000               | @ | 3.250 | 3.125              | @ | 3.270 |
| 2015                   | 3.500             | @ | 3.700 | 3.600                      |   |       | 3.600                      |   |       | 5.000               | @ | 3.450 | 5.000              | @ | 3.510 |
| 2016                   | 3.750             | @ | 3.850 | 3.700                      |   |       | 3.700                      |   |       | 4.500               | @ | 3.650 | 5.000              | @ | 3.630 |
| 2017                   | 3.750             | @ | 3.950 | 3.800                      |   |       | 3.800                      |   |       | 3.700               | @ | 3.800 | 5.000              | @ | 3.740 |
| 2018                   | 3.875             | @ | 4.050 | 4.000                      |   |       | 4.000                      |   |       | 3.900               |   |       | 5.000              | @ | 3.840 |
| 2019                   | 4.000             | @ | 4.150 | 4.100                      |   |       | 4.100                      |   |       | 4.000               |   |       |                    |   |       |
| 2020                   | 4.100             | @ | 4.250 | 4.125                      | @ | 4.150 | 4.125                      | @ | 4.150 |                     |   |       |                    |   |       |
| 2021                   | 4.200             | @ | 4.320 | 4.125                      | @ | 4.150 | 4.125                      | @ | 4.150 |                     |   |       |                    |   |       |
| 2022                   |                   |   |       | 4.200                      | @ | 4.300 | 4.200                      | @ | 4.300 |                     |   |       |                    |   |       |
| 2023                   |                   |   |       |                            |   |       |                            |   |       |                     |   |       |                    |   |       |
| 2024                   | 5.000             | @ | 4.330 |                            |   |       |                            |   |       |                     |   |       |                    |   |       |
| 2025                   |                   |   |       | 4.375                      |   |       | 4.375                      |   |       |                     |   |       |                    |   |       |

# Underwriter's Scope of Services in Negotiated Sale At Time of Bond Sale

## ◆ Use of the internet

 **Electronic distribution and posting of official statement**

 **Accepting orders on-line from institutional and retail investors**

 **Issuer can track the sale by accessing web site**

# Online Order Screen

Individual or Institutional Investors are able to enter orders for new issues during the initial order period

http://www.buybonds.com/onlinebonds/realtime.asp - Microsoft Internet Explorer provided by Stone & Youngberg LLC

File Edit View Favorites Tools Help

Back Forward Stop Search Favorites Print View Source

Address http://www.buybonds.com/onlinebonds/realtime.asp Go Links

**STONE & YOUNGBERG** LOGON TO YOUR ACCOUNT | OPEN AN ACCOUNT | SUBSCRIBE

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**The Order Monitor**

| Pricing Date | Par Amount  | Status | Issuer                                   | Ratings | Insurer    | POS                  |
|--------------|-------------|--------|--|---------|------------|----------------------|
| 03/25/2004   | \$6,465,000 | Open   | San Marcos Schls Fncg Auth Lease Rev Bds | /AAA    | XL Capital | <a href="#">Link</a> |

**Tax Exempt**

**\$6,465,000**  
**San Marcos Schools Financing Authority**  
**2004 Lease Revenue Bonds**  
**(North County Regional Educational Center)**

**Order Period Open**  
**Date: 03/25/2004 Time: 7:00AM Pacific**

**Order Period Close**  
**Date: 03/25/2004 Time: 10:00AM Pacific**

Dated date 04/08/2004  
 Delivery date 04/08/2004  
 Registration DTC Book Entry Only  
 First Coupon 11/01/2004  
 Optional Call date 11/1/12 @ par

**SIPC** Open Glossary

These securities are subject to availability and change in price. This posting is neither an offer to sell, nor a solicitation of an offer to buy these securities. Such an offer is made only by the official

**Realtime Order Flow by Maturity** Refresh

| Maturity Date | Coupon | Yield  | Price    | Principal Amount          | Subscriptions Qty | Avail | Remarks | Last Updated       |
|---------------|--------|--------|----------|---------------------------|-------------------|-------|---------|--------------------|
| 11/01/2004    | 2.000% | 1.000% | 100.560% | 325                       | 740               | (415) | Over    | 03/25/2004 10:18AM |
| 11/01/2005    | 2.000% | 1.150% | 101.313% | 230                       | 0                 | 230   | -       | 03/25/2004 10:18AM |
| 11/01/2006    | 2.000% | 1.300% | 101.759% | 235                       | 50                | 185   | -       | 03/25/2004 10:18AM |
| 11/01/2007    | 2.000% | 1.650% | 101.206% | 240                       | 240               | -     | -       | 03/25/2004 10:18AM |
| 11/01/2008    | 2.500% | 2.050% | 101.950% | 245                       | 250               | (5)   | Over    | 03/25/2004 10:18AM |
| 11/01/2009    | 2.500% | 2.300% | 101.038% | 250                       | 175               | 75    | -       | 03/25/2004 10:18AM |
| 11/01/2010    | 2.500% | 2.600% | 99.399%  | 260                       | 250               | -     | -       | 03/25/2004 10:18AM |
| 11/01/2011    | 3.000% | 2.850% | 101.012% | 265                       | 0                 | 265   | -       | 03/25/2004 10:18AM |
| 11/01/2012    | 3.000% | 3.150% | 98.880%  | 270                       | 0                 | 270   | -       | 03/25/2004 10:18AM |
| 11/01/2013    | 3.250% | 3.350% | 99.185%  | 280                       | 0                 | 280   | -       | 03/25/2004 10:18AM |
| 11/01/2014    | 3.250% | 3.500% | 97.806%  | 290                       | 340               | (50)  | Over    | 03/25/2004 10:18AM |
| 11/01/2015    | 3.500% | 3.650% | 98.593%  | 300                       | 0                 | 300   | -       | 03/25/2004 10:18AM |
| 11/01/2016    | 3.625% | 3.800% | 98.262%  | 310                       | 0                 | 310   | -       | 03/25/2004 10:18AM |
| 11/01/2017    | 3.750% | 3.900% | 98.429%  | 320                       | 0                 | 320   | -       | 03/25/2004 10:18AM |
| 11/01/2018    | 3.875% | 4.000% | 98.628%  | 335                       | 0                 | 335   | -       | 03/25/2004 10:18AM |
| 11/01/2019    | 4.000% | 4.100% | 98.855%  | 345                       | 0                 | 345   | -       | 03/25/2004 10:18AM |
| 11/01/2020    | 4.100% | 4.200% | 98.812%  | 360                       | 0                 | 360   | -       | 03/25/2004 10:18AM |
| 11/01/2021    | 4.200% | 4.300% | 98.773%  | 375                       | 375               | -     | -       | 03/25/2004 10:18AM |
| 11/01/2024    | 5.000% | 4.330% | 104.748% | 1,230                     | 1,230             | -     | -       | 03/25/2004 10:18AM |
|               |        |        |          | <b>Total Principal</b>    | <b>6,465</b>      |       |         |                    |
|               |        |        |          | <b>Total Subscribed</b>   | <b>3,190</b>      |       |         |                    |
|               |        |        |          | <b>Total Unsubscribed</b> | <b>3,275</b>      |       |         |                    |

Done

Start Internet Desktop 10:36 AM

Link to Official Statement

Issuer Clients are able to monitor order flow during order period

# Underwriter's Scope of Services in Negotiated Sale After Bond Sale

- ◆ **Provide for delivery of funds on closing date**
- ◆ **Provide advice as to reinvestment of bond proceeds**
- ◆ **Provide post-sale analysis of where securities were placed**
- ◆ **Provide secondary market for issuer's securities**

# Underwriter's Scope of Services in Competitive Sale Prior to Bidding

- ◆ **Underwriters / traders, not bankers perform these services**
- ◆ **Review notice of inviting sale setting forth terms of bond sale, review final preliminary official statement for qualification of underwriting bid**
- ◆ **Assess pre-sale interest levels from potential investors and sales people**
- ◆ **Assess other bids on calendar, existing relationship with issuer, current bond inventory and capital allocation, and prioritize the bid accordingly**

# Recent Notice of Sale

NOTICE OF INTENTION TO SELL

**\$8,000,000\***

**CLAREMONT UNIFIED SCHOOL DISTRICT  
(LOS ANGELES COUNTY, CALIFORNIA)**

**ELECTION OF 2000 GENERAL OBLIGATION BONDS, SERIES C**

NOTICE IS HEREBY GIVEN that the Claremont Unified School District (the "District"), in Los Angeles County, California, intends to offer for public sale on **Tuesday, April 20, 2004**, at the hour of 10:00 a.m. Pacific Standard Time at the office of Superintendent of the Claremont Unified School District (the "Superintendent"), 2080 N. Mountain View St., Claremont, California 91711, not to exceed \$8,000,000\* principal amount of general obligation bonds of the District designated "Claremont Unified School District (Los Angeles County, California) Election of 2000 General Obligation Bonds, Series C (the "Bonds"). Within 26 hours, the Superintendent will consider the bids received and, if acceptable bids are received, award the sale of the Bonds on the basis of the true interest cost. In the event that no bids are awarded by the designated time, the sale shall be postponed to a subsequent time and date to be determined via Bloomberg News Service or TM3.

NOTICE IS HEREBY FURTHER GIVEN that the sale subject to the terms and conditions of the Notice dated April 7, 2004. An Official Statement and the Bonds will be furnished upon request mailed to Mr. John A. Ach, The Presidio, 1004B O'Reilly Avenue, San Francisco, CA 94115 (www.nhainc.net), the financial advisor to the District.

Dated: April 2, 2004

CLAREMONT UNIFIED SCHOOL DISTRICT

By: /s/ Ralph Patterson  
Assistant Superintendent, Business Services

**\$8,000,000\***

**CLAREMONT UNIFIED SCHOOL DISTRICT  
(LOS ANGELES COUNTY, CALIFORNIA)**

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# Underwriter's Scope of Services in Competitive Sale at Time of Bidding

- ◆ Arrive at combination of interest rates and underwriter compensation that will bring a sufficient return to the firm
- ◆ Phone, fax or electronically submit bid
- ◆ If winning bidder, open up order period for firm's salespeople and offering levels to the "street"
- ◆ If losing bidder, on to the next one

# Underwriters' Compensation

- ◆ **Underwriter's discount is present in both negotiated and competitive sales**
- ◆ **Discounts vary due to credit quality of securities (insured, rated or non-rated)**
- ◆ **Component amounts generally move in inverse relationship to the size of the issue**

# Underwriters' Compensation

## ◆ Four components

- 📄 **Management Fee - Investment banking, Syndicate manager**
- 📄 **Takedown - Compensation for the sales effort**
- 📄 **Underwriting Risk - Compensation to underwrite securities not presold**
- 📄 **Expenses - Reimbursable out-of-pocket expenses of the underwriter**
  - **Underwriter's Counsel**
  - **Regulatory Fees - MSRB, PSA, CDIAAC**
  - **Travel, FedEx, messenger, conference calls, etc.**

# Sample Underwriter's Discount

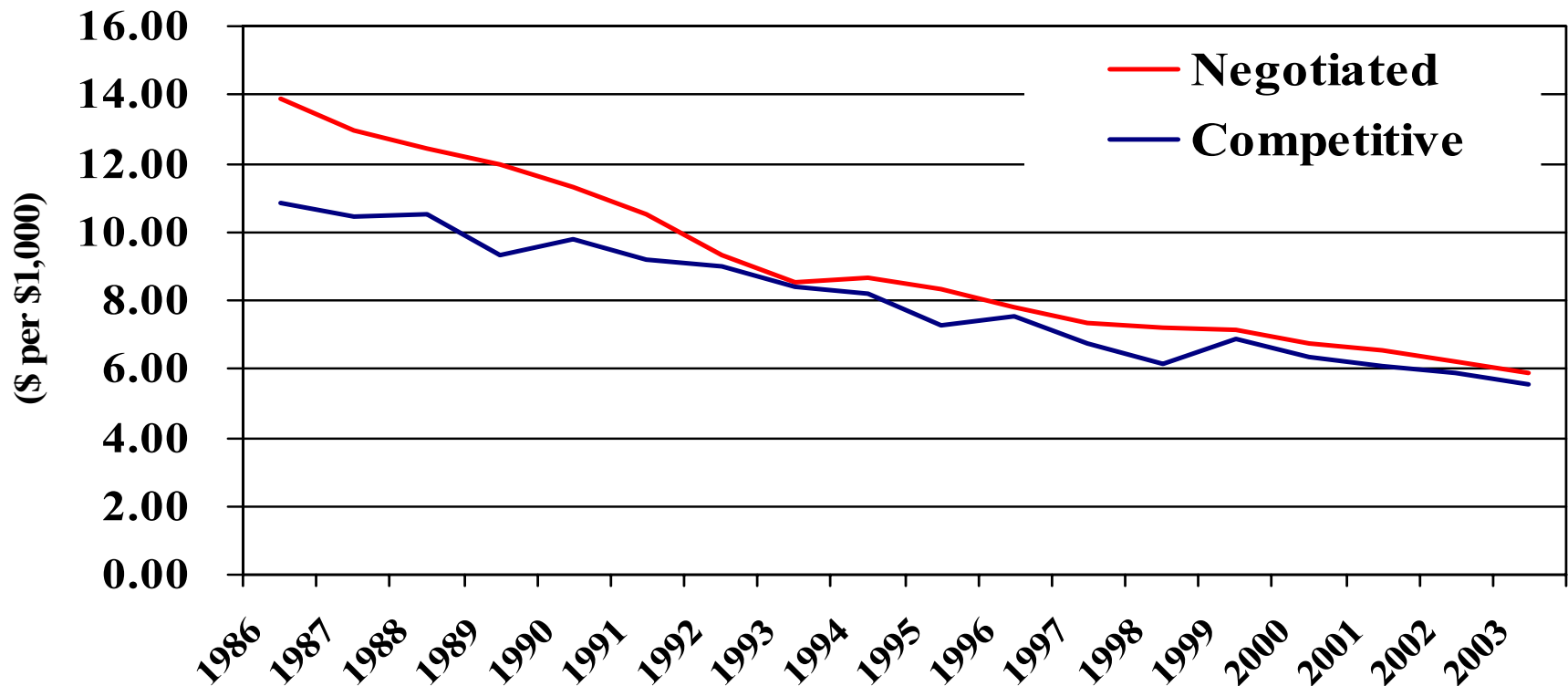
## \$15 Million - A Rated Financing

| Component               | (\$/\$1,000) | Fee           |
|-------------------------|--------------|---------------|
| Management Fee          | \$1.33       | \$19,950      |
| Average Takedown        | 4.14         | 62,100        |
| Underwriting Risk       | 0.50         | 7,500         |
| Expenses <sup>(1)</sup> | <u>1.90</u>  | <u>28,500</u> |
|                         | \$7.87       | \$118,050     |

<sup>(1)</sup>Includes Underwriter's Counsel fee of \$1.20/\$1,000 or \$18,000

# Historical Average Underwriting Spreads

1986 through 2003\*



Source: Bond Buyer

\*Through December 31, 2003